# Financial Ratios Analysis

This playbook provides a guide on how to calculate and interpret key financial ratios for effective business analysis. It outlines the steps necessary to understand different metrics that indicate the financial health of a business.

### Step 1: Gather Data

Collect the necessary financial documents such as the balance sheet, income statement, and cash flow statement. These statements contain the figures required to calculate financial ratios.

### Step 2: Liquidity Ratios

Calculate liquidity ratios to assess the company's ability to pay off its short-term debts.

- \*\*Current Ratio\*\*: Divide current assets by current liabilities.
- \*\*Quick Ratio\*\*: Subtract inventory from current assets, then divide by current liabilities.

### Step 3: Solvency Ratios

Compute solvency ratios to evaluate the company's ability to meet long-term obligations.

- \*\*Debt to Equity Ratio\*\*: Divide total liabilities by shareholder's equity.
- \*\*Interest Coverage Ratio\*\*: Divide earnings before interest and taxes (EBIT) by interest expenses.

### Step 4: Profitability Ratios

Analyze profitability ratios to understand the company's ability to generate profit.

- \*\*Net Profit Margin\*\*: Divide net income by revenue.
- \*\*Return on Assets (ROA)\*\*: Divide net income by total assets.
- \*\*Return on Equity (ROE)\*\*: Divide net income by shareholder's equity.

### Step 5: Efficiency Ratios

Measure efficiency ratios to determine how effectively the company uses its assets and liabilities.

- \*\*Asset Turnover Ratio\*\*: Divide revenue by total assets.
- \*\*Inventory Turnover\*\*: Divide cost of goods sold by average inventory.

### Step 6: Market Value Ratios

Assess market value ratios to gauge the company's stock valuation.

- \*\*Price-Earnings (P/E) Ratio\*\*: Divide market value per share by earnings per share (EPS).
- \*\*Earnings Yield\*\*: Divide EPS by market price per share.

### Step 7: Interpret Results

Review the calculated ratios and compare them with industry standards or historical data to interpret the company's performance. Look for trends or anomalies that could indicate financial health or concerns.

### Step 8: Make Decisions

Use the interpretation of the financial ratios to inform business decisions. Consider actions such as adjusting strategies, improving operations, or communicating financial health to stakeholders.

## General Notes

### Industry Benchmarks

It's important to compare financial ratios with industry benchmarks for a relevant analysis. Ratios can vary significantly across different industries.

### Historical Context

Analyzing ratios over time can provide insights into trends and long-term performance, rather than relying solely on a snapshot of current data.

### Comprehensive Analysis

A single ratio does not provide a complete picture. Always consider a range of ratios for a holistic view of the company's financial condition.